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Answer-to-Question-_1_

To: Directors of Briggs Limited

From: Danny Pine of AD Accounting

Date: 1 November 2024

Report on removal of dianna and pedro as minority shareholders of Briggs Limited, and increasing Henry's shareholding

Intro

In this report we set out the tax efficient way to remove Pedro as a shareholder, in addition to increasing Dianna's income in retirement. We also look at the best way to increase Henry's shareholding subject to conditions being met.

Disclaimer

This report is soley for the benfit of Briggs Limited, we are not liable for any other parties that rely on this advice. The calculations of Pedro's and Dianna's tax liabilities are for illistrative purposes only.

Executive summary

The redundacy package for Pedro would be £120k ex-gratia, £60k PILON (payment in liue of notice), he will have earned £80k salary in the 8 months in the tax year to November 2024. £30k of the ex-gratia payment would be free of income tax with the rest falling into scope. The balance of £90k is outside the scope of NIC for Perdo however class 1A NIC will be payable by the company. Perdo's net income would be 163,727 for the period to November 2024.

We review the methods to purchase Pedro's shares and conclude that a repurchase of shares by the company is the most tax efficient route, this would qualify as a capital disposal for Pedro, the conditions are quite narrow however all are met. This results in a capital gain of £39,532 for Pedro.

Dianna's shares could be repurchased in the same way as Pedro's however we conclude that a repurchase over time is the best result for Dianna, being a lower rate tax payer and providing a stable income, we estimate a 7 year repurchase timeframe to minimise the tax payable, this also gives sufficient time for Briggs Limited to generate the cashflow required.

A review of various options schemes are discussed with the contraints of Henry not being able to increase his working hours or paying over par value, the conclusion is that unapproved options are the best way to proceed. We also discuss the issue of restricted shares however due to the tax complications of these we do not recommend this method.

Exit of Pedro from the business

The removal of Pedro is in two steps he and the company will incure tax on the exit of the company from his reundancy payment, which we have reviewed below to allow for cashflow planning, in addition to highlighting the cashflow advantages of Pedro to ease any transition. We have also reviewed the options on how best to remove Pedro as a shareholder.

<u>Pedro's income tax liability on exit</u>

Pedro is to recieve £120,000 as an ex-gratia payment. The current tax regime allows for £30k to be paid free of income tax. The remainder is taxable, the excess is commonly refered to as Top-sliced income this means it's taxed last out of his income, as we don't have Pedro's dividend history we can't comment on his exact tax position, we have however provided a brief summary that may be useful assuming no saving or dividend income in appendix 1.

He would lose his personal allowance, and have his pension allowance restricted. Overall he will have a net income £163,727 for the 2024/25 tax year.

The payment in lieu of notice is simply salary and therefore class 1 primary and secondary NICs are due on this amount. The ex-gratia termination payment is not in scope of class 1 Primary NIC, however class 1A will be payable by the company for the excess ie £90k at 13.8%. All payments ie gross payments to Pedro and NIC class 1 secondary/Class 1A are allowable for corporation tax for the year ending June 2025.

Removal of pedro's shares

There are two paths avalible for the purchase of Pedro's shares either Michael could buy the shares personally with a loan, or the company can repurchase the shares, this would increase everyone's shareholding.

Purchase of shares by Michael

If Michael were to purchase the shares personally this would be via a loan. If a bank loan was to be used then the interest would be deductable for income tax purposes as it is a qualifying loan used to buy shares in a close trading company. The alternative is that Briggs Limited loans the money to Michael, this could be at a commercial rate of interest at which the income for the company would be taxable under corporation tax and the interest charged again would be deductable for income tax. Given Michael is the largest shareholder the re-extraction of this money would not be tax efficient therefore we would recommend the loan be interest free.

If an interest free loan were to be provided to Michael, a benefit would exist normally chargable at the official rate of interest (currently 2.25%), however as noted above the loan is a qualifying loan and therefore no benefit in kind would be due. Therefore no P11d would need to be produced by the company reducing the admin burden of the company.

The other impact of the over drawn loan in a close company is that S455 tax would be due on the balance, assuming £550k proceeds and therefore loan (Appendix 2), the S455 tax would be £185,625 for the year end June 2025 this would be payable 9 months and 1 day after the year end being 1 April 2026. The loan could then be cleared via increased dividends over time to reduce the amount that falls into the higher / additional rates of income tax. This has the benfit of using the surplus cash that have assumulated in the business. There is a small risk that the loan could reduce any Business property relief if any of the shareholders were to die before the loan is repaid. However this is likely to be minimal risk as the value would be in and around 20% of the balance sheet assets, require minimal management time and generate no income. Given the repayment of the loan would need to come from additional income charged on Michael we would not recommend this and thus propose the second option which is the company buys the shares from Pedro.

S455 tax would be recovered at the tax due date 1 April following the year end, for any reduction in the loan balance. This would be a credit agasint the corporation tax due and if the credit is greater than the amount due then a repayment will be made by HMRC.

Purchase of own shares

A company can purchase it's own shares from a shareholder these are then either cancelled or held as treasury shares for reissue, from a tax point of view they are largely similar.

The repurchase of shares has two treatments either as a distrubiton taxable as income which is the default or if certain criteria are met then the sale is treated as a capital disposal subject to capital gains tax (CGT).

Under the income route, the proceeds are split between capital gain, the proceeds are deemed to be the original subscription price, and the balance treated as a dividend. As pedro obtained the shares from Michael the proceeds would be £2000 less his base cost of £200,000 which would create a significant capital loss. Pedro would be able to offset other capital gains in the year and if any losses remain carry these forward. The balance of the proceeds being £548,000 would be taxable as dividend subject to 39.35% as with his income in the year he would be an additional rate tax payer.

To qualify as capital route 5 conditions must be met, which are:

Pedro must be a UK tax resident, he is.

The shares must be in a close trading company. Briggs limited is as noted above as a result of control by 5 or fewer participators (shareholders).

The purchase of shares must reduce the shareholders ownership by at least 25%, this considers the ownership percentage before and after the transation. He currently owns 19.4% and therefore must own 14.5% or less after the repurchase and cancelation of the repurchased shares. The plan is for all the shares to be purchased in one tranche.

The shareholder must not remain attached to the company, these means repayment causing a loan balance to be due would not qualify, and that a shareholders ownership is below 30%. We are proposing a repayment via the accumulated cash and his ownership is already below 30%.

Finally the repurchase must be in the best interest of the trade to qualify. Given the significant falling out between yourself and Pedro this would most certainly qualify and is a specific example provided by HMRCs guidance.

With the capital route being the best option for both parties we recommend the repurchase is performed to qualify the above requirements. This would result in a tax payable as calcated in Appendix 2 of £39,532 for Pedro, this is because his gain would be within his Business asset disposal relief (BADR) limit of £1m, as previously discussed he hasn't previously realised any BADR gains.

To qualify for BADR greater than 5% of the ordinary shares must be held in a trading company for two years while being an employee for those years. The shareholder must also own the rights to >5% of the profits or distributions on a winding up. We therefore recommend the purchase of own shares is completed before his redundancy.

Administration of purchase of own shares

The articals of the company will need to be reviewed to ensure it is legal to perform, if not they would need to be changed. A special resolution would need to be raised at a shareholder meeting and would require 75%, this can be achieved without Pedro's assistance provided Dianna and Henry are happy to vote with you. The company must also have sufficient retained profits to complete the purchase, this is not an issue for Briggs Limited.

Stamp duty on purchase of shares

Under both cases as the shares are being purchased for greater than £1k, there would be stamp duty payable by either the company or Michael depending on which option is chosen. This would be at 0.5% and therefore £2,750.

Removal of Dianna as a shareholder

With Dianna still on good terms with the company, there are more options avalible than for Pedro. As noted above there are two routes either the income route or capital route, there is not a choice in this however the capital route is much narrower and therefore we can breach one of the requirements to force the income route.

Under the capital route assuming a similar market price for the shares of £275 this would result in a gain of £213,200, this would be taxed at Dianna's marginal rates as she is not able to obtain BADR because she is not an employee. This would result in a CGT tax liability calculated at 10/20% after having used her Annual exempt amount of £39,532 (appendix 3).

The other option would be for Dianna's shares to be purchased over time, we estimate in appendix 3 this would could be paid over 7 years which would utilise her basic rate band allowing for the payments to be taxed as distributions which is at 8.75% for Dianna. This is more tax efficient as at a lower marginal rate and therefore we would recommend that the transaction is performed this way. In addition to allowing the company's cash reserves to be built back up from the purchase of Pedro's shares.

To achieve this and due to Dianna's low share holding it will be important to ensure that the shareholding after the repurchase of shares is above 75%, in the first year she would be able to sell upto 200 shares this would result in a share holding after of 7.4% which is greater than the 7.2% required for a capital route (600/8100 post pedro disposal), this is greater than what is initially required for a £31,000 distribution.

Dianna is in poor health and asset rich, this does propose an issue with IHT currently her shares would qualify for business property relief (BPR) at 100% this is because Briggs

Limited is an unquoted trading company and Dianna has held the shares for over 2 years. The benefit of BPR is that the shares would recieve 100% relief from any IHT liability, effectively removing from her taxable estate at death. If she were to realise the funds then any excess cash would be taxable on her death. Given she needs the funds to increase her quality of life in retirement, which is more important than avoiding tax, this is not a major issue and therefore we would still recommend that she allows the share to be repurchased over time.

Increasing Henry's shareholding

There are normally multiple ways for a company to increase an employee shares holding, either providing restrictive shares or using share option schemes these are however limited given his restricted hours and only able to pay par (£1 per share) this restricts the avalible options quite heavily.

Options not suitable

We want to highlight the options that aren't avalible incase Henry were able to accomodate these in the future.

EMI option scheme

EMI is not a possibility because he only works 20 hours a month, the minimum requirement to allow EMI options to be issued is 25 hours per week or 75% of his working hours, assuming he performs 20 hours with each of the other 4 businesses he is unlikely to qualify.

EMI options have be benefit of being able to be issued below market value, this would mean the option can be granted at par value. The tax consequences of this is included in the unapproved option scheme below. Options upto £250k can be provided per employee this would give options over shares upto 909 (250k/275), allowing for ownership to increase to 10%

CSOP option scheme

CSOP scheme is not possible as Henry only wants to pay par value, CSOP options can't be granted for less than par value ie £275 per share. Options upto £60k per employee can be granted 218 shares. This is also not ideal as would only increase to 6.7% compared to the 10% noted, a mix of CSOP and unapproved schemes could be used to achieve the desired shareholding. Additionally if Henry doesn't have the funds to purchase the shares, the company could loan the money subject to the same requirements as noted above for loans from close companies. Given the restrictions we wouldn't recommend this method as likely untenable for Henry in any regard.

SIP

Share investment plans allow for small amounts of shares to be gifted/purchased, the plan must be open to all employees, as such we won't mention them further as significantly outside the scope of what the desired outcome is.

<u>Unapproved option schemes</u>

Unapproved option schemes allow a way of incentiving directors and staff without the restrictions of approved schemes. This comes at the drawback that they are not tax advantaged. On the basis that Pedro and Dianna's shares are repurchased from the company and to give Henry a 10% share holding he would be granted options over 500 shares, exercise price of £1 each on the companys turnover increasing to or above £3,017k (35% of June 2024 figures), and Henry still working for the company.

On grant there is no tax consequences for either Henry or the company.

On exercise there will be income tax due, this will be the difference between the market value at exercise and the price paid. Assuming a 35% increase in the par value of the shares (275*35%) a price of £371 per share, then £185,000 of income would be subject to Income tax for Henry. He would be required to dislose this on his self assessment in the tax year of excerise, due by 31 Janaury the year after.

If the shares were readily coverable assets, for example if the company were to be sold within the 2 years and are exercisable on an exit, or if there were arrangements put in place for the shares to be sold then they would also be within the scope of national insurance for both the company and Henry (Class 1 primary/ secondary). This could result in a charge for the company of £25,530, 13.8% of the market value at exercise. Income tax and class 1 primary NIC would be payable via payroll, given the dry tax charge for Henry his income from payroll may be deducted with no cap, if the full PAYE/NIC liability isn't settled by the year end then this would be payable by Henry.

The base cost of the shares for any subsequent disposal would be that of the market value at grant. Share pooling would be required for Henry due to the mixture between £90 and £371.

On exercise the company would obtain a coporation tax deduction being equal to the market value less price paid therefore £185k reduction in taxable profits. £46,250 assuming 25% CT.

Henry may qualify for investors relief provided he doesn't recieve income for his NED (non excutive director) duties. The additional shares would not void any claim to this investors relief the gain would be prorated on eventual sale of the shares between those held before he was employed as a NED ie 300 shares and the ones obtained via options while he was a NED. If he owned the new shares for 2 years he would qualify for BADR, as he previously owned less than 5%.

With the flexibility of the option scheme and no immediate tax charge and given the constrains we recommend that unapproved options are granted to Henry.

The grant of options would need to be reported to HMRC as it is an employment related security, annual filing would need to be performed by 6 July, and when the options are exercised this would also need to be disclosed to HMRC. We would recommend that an external review of the market value is performed for the purpose of attaining a valuation of the shares when exercised, and approiate discloser made within the corporation tax return to mitigate a possible enquiry.

Issue of restrictive shares

Shares with restrictions over sale/dividends could be issued such that the shares are non transferable within 2 years and if turnover has not increased by 35% within 2 years they must be sold back to the company for par value or converted to deferred shares with no rights or value.

This is an issue of restricted shares, the restriction would lift after 2 years, and not soley time based ie there are market restrictions. As they would be due to forfiture within 5 years no income tax charge is due immediately. When the risk of forfeiture is lifted a charge arises on the value of the shares less any amounts paid for them or already charged to income tax. An election can be made to tax the shares immediately this would reduce the overall tax charge however this can't be undone so if the shares were purchased Henry would have paid income tax and have a capital loss, as such this isn't recommended.

Due to the uncertainty of the above share issue, and the flexibility that share options provide we wouldn't recommend this option.

Appendix 1 Calculation of Pedro income tax liability on exit

We have assumed he will be removed at the end of November 2024 and therefore receive the additional PILON payment. We have also ignored any dividends that may have been paid during the tax year.

	£		
Salary	80,000		
Payment in lieu of notice	60,000		
Ex-gratia	120,000		
Less allowance	(30,000)		
Total income	230,000		
No PA			
Basic rate	7540		
Higher rate	34976	(87440*40%)	
Additional rate	47187	(104860*45%)	
Total IT	**89703**		
NIC	4524	(37700 *12%)	
	2046	(102,300 *2%)	
	6570		
Total tax	96273		

Net income £163,727

Appendix 2 Calculation of disposal of Pedro's shares via purchase

Pedro obtained the shares in June 2017, when the market value was £100 therefore his base cost is £200,000. Proceeds are expected to be £275 per share so £550,000.

	BADR Gain (£)		
Proceeds	550,000		
Cost	(200,000)		
AEA	(6,000)		
Gain	344,000		

Tax at 10%	**34,400**		

Appendix 3 Calculation of Dianna share disposal

	BADR Gain (£)		
Proceeds	220,000		
Cost	(800)		
AEA	(6000)		
Gain	213,200		
Tax 10%	3,107	31074 (10%)	
Tax 20%	36,425	182126 (20%)	
Total CGT	39,532		

Basic rate band left	31000	(37,700 - 6626) rounded	
Proceeds	220,000		
Years to extract in basic rate band	7		

Note: The actual effective rate is lower than 8.75% due to unused dividend allowance (£1k).